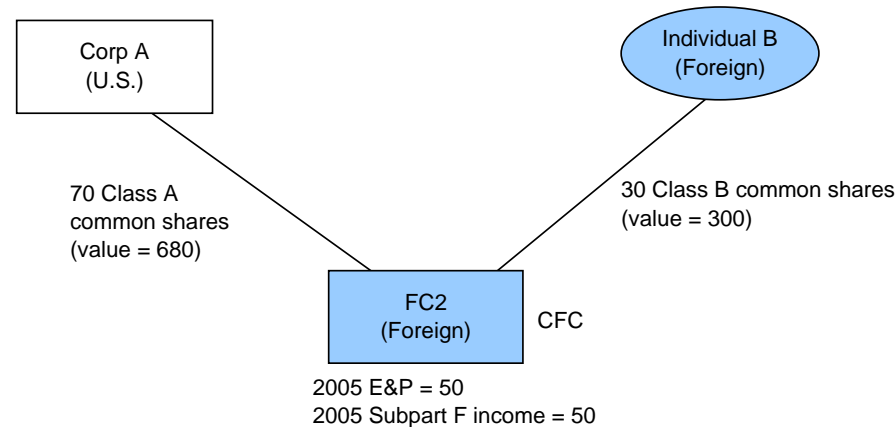


Reg. 1.951-1(e)(6), Example 3

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Pro Rata Share - Two Classes of Common Treated as One Class



FC2, a CFC, has outstanding 70 shares of common stock and 30 shares of Class B common shares. The board of directors of FC2 may declare dividends with respect to one class of stock without declaring dividends with respect to the other class of stock. Corp A, a domestic corporation and a United States shareholder of FC2, owns all of the common shares. Individual B, a foreign individual, owns all of the preferred shares. Corp A and Individual B are shareholders of FC2 for its entire 2005 taxable year. For 2005, FC2 has \$50x of earnings and profits, and subpart F income of \$50x. FC2 makes no other distributions during that year. The value of the Class A common shares on the last day of FC2's 2005 taxable year is \$680x and the value of the Class B common shares on that date is \$300x. The board of directors of FC2 determines that FC2 will not make any distributions in 2005 with respect to the Class A and B common shares of FC2.

The allocation of FC2's earnings and profits between its Class A and Class B common shares depends solely on the exercise of discretion by the board of directors of FC2. The allocation of earnings and profits between the Class A and Class B common shares will depend on the value of each class of stock on the last day of the CFC's taxable year. On the last day of FC2's taxable year 2005, the Class A common shares had a value of \$9.71x/share [the regulations state that the value is \$9.30x per share, but this appears to be an error] and the Class B common shares had a value of \$10x/share. Because each share of the Class A and Class B common stock of FC2 has substantially the same value on the last day of FC2's taxable year, for purposes of allocating the earnings and profits of FC2, the Class A and Class B common shares will be treated as one class of stock. Accordingly, for FC2's taxable year 2005, the earnings and profits of FC2 are allocated \$35x ($70/100 \times \$50x$) to the Class A common shares and \$15x ($30/100 \times \$50x$) to the Class B common shares. For its taxable year 2005, Corp A's pro rata share of FC2's subpart F income will be \$35x.